Testimony of Barry C. Hawkins
Commissioner of Uniform Laws
for the State of Connecticut and Chairman of the Drafting Committee for
The Uniform Prudent Management of Institutional Funds Act.
In Support of House Bill 5978,
An Act Concerning the Uniform Prudent Management of Institutional Funds Act
Government Administration and Elections Committee
March 16, 2007

Thank you for the opportunity to comment in support of House Bill 5978, An Act Adopting the Uniform Prudent Management of Institutional Funds. My name is Barry C. Hawkins of 15 Armitage Drive in Bridgeport, Connecticut. I am a Partner in the firm of Shipman & Goodwin, LLP resident in its Stamford office. Since 1999 I have served as one of the Commissioners of Uniform Laws for the State of Connecticut. In that capacity I serve as one of the commissioners from Connecticut in the National Conference of Commissioners on Uniform State Laws which is often referred to as "NCCUSL".

In October 2000 I was asked by NCCUSL to serve on a Study Committee to determine whether the 1972 Act UMIFA (The Uniform Management of Institutional Funds Act), which had been enacted in 47 states and the District of Columbia, should be revised and updated to reflect the changes which had occurred over nearly three decades.

To address the problems which had become increasingly apparent, the Study Committee recommended that a revised version of UMIFA be drafted. In 2002 a national drafting committee was appointed which worked for four years in drafting a new and improved act which was adopted in final form by NCCUSL in July 2006. It was my privilege to serve as the Chair of the Drafting Committee. An additional Connecticut Commissioner, Professor John Langbein of Yale University Law School, joined me on the 9 person national drafting committee, making Connecticut the only jurisdiction with multiple representatives.

This new Act provides statutory guidelines for the management, investment and expenditure of endowment funds held by charitable institutions. To rectify the problems that had developed over the years with UMIFA, the new act expressly highlights the prudence factors developed in case law and in statutory advances like the Prudent Investment Act, better allowing for diversification of assets and total return expenditure, emphasizing whole or modern portfolio management. To reflect its roots in the prudence concept it was named Uniform Prudent Management of Institutional Funds Act ("UPMIFA").

UPMIFA governs a hugely important segment of the national and state economy. In 2004 the latest statistical years available, there were 1.4 million non-profit organizations in the United States exclusive of churches. These charities have assets of more than Three Trillion Dollars and constitute over 5% of our Gross Domestic Product and over 8% of all employment. It is not all money. In 2004 nearly one-third of all U.S. adults donated personal time and effort to these charitable institutions. In Connecticut alone, as of 2004 we had nearly 5000 reporting institutions (excluding churches and those with receipts under $25,000, which are not required to report). In employment terms non-profits are the second largest employment sector in the State of Connecticut. Those Connecticut organizations collected over 20 Billion Dollars in 2004 and managed assets in excess of $57 Billion. On the basis of revenue given to charitable institutions per 1000 people, Connecticut is the third most generous state in the Union. It is truly fitting that Connecticut be among the Country's leaders in providing modern legislation governing institutional funds.

I have attached to my testimony a Summary of the most important features of UPMIFA, to which I direct you for greater detail on the problems with the current UMIFA statute and how UPMIFA improves the Law.

UPMIFA is a default statute. It provides the governing law for charitable gifts, only if the donor has not specifically provided for a different result. In all ways, the donors' expressed wishes will continue to govern all gifts. The laws contained in UPMIFA apply only as an aid to determining what the donor would have expressed if the donor had chosen to do so.

I would also like to mention that I have been engaged in extensive discussions with the Connecticut Attorney General's office ("AGO"), concerning its position on UPMIFA. We have agreed that if Section 6(d) of House Bill No. 5978 is deleted, the AGO is prepared to support enactment of UPMIFA. The original Section 6(d) was a very desirable feature of UPMIFA but we have determined that Connecticut can get along without this new method of terminating small, obsolete gift funds and the AGO would prefer not to have it as part of our laws, believing that other existing Connecticut law on this subject would be sufficient. We have further agreed that it would be appropriate to amend House Bill 5978 with the following provision as a substitute for Section 6(d):

> "Nothing in this Section shall be construed as amending or altering existing standards in Connecticut law for approximation, cy pres or equitable deviation actions."

With this negotiated accommodation to the AGO, we know of no opposition to UPMIFA, which has been endorsed by most of the Country's charitable organizations, educational institutions, legal advisors for donors and by many of the regulators who watch over them.

UPMIFA reflects the nearly 35 year old experience with UMIFA and brings it in line with the standards of modern prudence. Rather than changing institutional investment or expenditure practices it brings them up to date and unifies them. The better you assist charitable institutions to manage investment and prudently control expenditures, the more money they will have for accomplishing their charitable objectives.

UNIFORM PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS ACT

- A Summary -

At its annual meeting in July 2006, the National Conference of Commissioners on Uniform State Laws (NCCUSL) approved the Uniform Prudent Management of Institutional Funds Act (UPMIFA) and recommended it for enactment by the legislatures of the various states. UPMIFA is designed to replace the existing Uniform Management of Institutional Funds Act (UMIFA), which was approved by NCCUSL in 1972 and has since been enacted in 47 states. UMIFA was a pioneering statute, providing uniform and fundamental rules for the investment of funds held by charitable institutions and the expenditure of funds donated as "endowments" to those institutions. Those rules supported two general principles: 1) that assets would be invested prudently in diversified investments that sought growth as well as income, and 2) that appreciation of assets could prudently be spent for the purposes of any endowment fund held by a charitable institution. These two principles have been the twin lodestars of asset management for endowments since UMIFA became the law of the land in nearly all U.S. jurisdictions,

UPMIFA continues these fundamental principles as a needed upgrade of UMIFA. Both investment in assets and expenditure for charitable purposes have grown exponentially in the 35 years since UMIFA was drafted; asset management theory and practice have also advanced. UPMIFA, as an up-date and successor to UMIFA, establishes an even sounder and more unified basis for charitable fund management than UMIFA has done.

INVESTMENT

In 1972, UMIFA represented a revolutionary advance over prevailing practices which imposed upon endowments the limited investment opportunities available for managing trust assets – even endowments not organized as trusts. By stating the first prudent investor rule in statutory law, UMIFA allowed endowments to invest in any kind of assets, to pool endowment funds for investment purposes, and to delegate investment management to other persons (*e.g.*, professional investment advisors), as long as the governing board of the charitable institution exercised ordinary business care and prudence in making these decisions. A range of factors guided the exercise of prudence.

UPMIFA incorporates the experience gained in the last 35 years under UMIFA by providing even stronger guidance for investment management and enumerating a more exact set of rules for investing in a prudent manner. It requires investment "in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances." It requires prudence in incurring investment costs, authorizing "only costs that are appropriate and reasonable." Factors to be considered in investing are expanded to include, for example, the effects of inflation. UPMIFA emphasizes that investment decisions must be made in relation to the overall resources of the institution and its charitable purposes. No investment decision may be made in isolation, but must be made in light of the fund's entire portfolio, and as a part of an investment strategy "having risk and return objectives reasonably suited to the fund and to the institution." A charitable institution must diversify assets as an affirmative obligation unless "special circumstances" dictate otherwise. Assets must be reviewed within a reasonable time after they come into the possession of the institution in order to conform them to the investment strategy and objectives of the fund. Investment experts, whether in-house or hired for the purpose, are held to a standard of care consistent with that expertise.

UMIFA initiated the era of modern portfolio management for charitable institutions. UPMIFA provides the standards and guidelines that subsequent experience tells us are the most appropriate for the purpose. Charitable institutions will have more precise standards to guide them. Courts will have more precise standards with which to measure prudence in the event of a challenge. The result should be more money for programs supported by charitable funds, including endowments.

EXPENDITURE

UMIFA initiated the concept of total return expenditure of endowment assets for charitable program purposes, expressly permitting prudent expenditure of both appreciation and income and replacing the old trust law concept that only income (*e.g.*, interest and dividends) could be spent. Thus, asset growth and income could be appropriated for program purposes, subject to the rule that a fund could not be spent below "historic dollar value."

UPMIFA builds upon UMIFA's rule on appreciation, but it eliminates the concept of "historic dollar value." UPMIFA, instead, provides better guidance on prudence and makes the need for a floor on spending unnecessary. UPMIFA states that the institution "may appropriate for expenditure or accumulate so much of an endowment fund as the institution determines to be prudent for the uses, benefits, purposes and duration for which the endowment fund is established." Seven criteria guide the institution in its yearly expenditure decisions: "1) duration and preservation of the endowment fund; 2) the purposes of the institution and the endowment fund; 3) general economic conditions; 4) effect of inflation or deflation; 5) the expected total return from income and the appreciation of investments; 6) other resources of the institution; and, 7) the investment policy of the institution." These standards mirror the standards that apply to investment decision-making, thus unifying both investment and expenditure decisions more concretely.

UPMIFA includes an optional provision that allows states to enact another kind of safeguard against excessive expenditure. If a state does not want to rely solely upon the rule of prudence provided in UPMIFA, the state may adopt a provision that creates a rebuttable presumption of imprudence if an institution expends an amount greater than seven percent of fair market value of a fund, calculated in an averaging formula over three years. While the seven percent rule is likely not to be necessary, it is available for those states that may be uncomfortable with the general standards.

RELEASE OR MODIFICATION OF RESTRICTIONS

UPMIFA recognizes and protects donor intent more broadly than UMIFA did, in part by providing a more comprehensive treatment of the modification of restrictions on charitable funds. Sometimes a restriction imposed by a donor becomes impracticable or wasteful or may impair the management of a fund. The donor may consent to release the restriction, if the donor is still alive and able to do so, but if the donor is not available the charity can ask for court approval of a modification of the restriction. The trust law doctrines of cy pres (modifying a purpose restriction) and deviation (modifying a management restriction) probably already apply to charitable funds held by nonprofit corporations. UPMIFA makes this clear. Under UMIFA, the only option with respect to a restriction was release of the restriction. UPMIFA instead authorizes a modification that a court determines to be in accordance with the donor's probable intention. If the charity asks for court approval of a modification, the charity must notify the state's chief charitable regulator and the regulator may participate in the proceeding.

UPMIFA adds a new provision that allows a charity to modify a restriction on a small (less than $25,000) and old (over 20 years old) fund without going to court. If a restriction has become impracticable or wasteful, the charity may notify the state charitable regulator, wait 60 days, and then, unless the regulator objects, modify the restriction in a manner consistent with the charitable purposes expressed in any documents that were part of the original gift.

CONCLUSION

UPMIFA reflects and incorporates the 35 years of experience that has accumulated under the original UMIFA. Rather than changing institutional investment or expenditure practices, it brings them up to date and unifies them across a broad range of charitable funds. The better charitable institutions manage investments and prudently control expenditures, the more money they should have for program purposes.